

## Internal Revenue Service

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### LEGEND:

Decedent  
Trust

State  
Trustee  
Date 1  
Date 2  
Date 3  
Date 4  
Date 5  
Date 6  
Daughter 1  
Daughter 2  
County Court  
State Statute 1  
State Statute 2  
State Statute 3  
Citation 1

Dear :

This responds to your April 16, 2010 letter requesting a ruling under § 2601 of the Internal Revenue Code concerning the generation-skipping transfer (GST) tax consequences of a proposed reformation of Trust.

You have requested the following ruling:

The proposed reformation of Trust will not cause Trust to lose its status as a GST exempt trust or become subject to the provisions of Chapter 13 of the Internal Revenue Code.

The facts submitted are as follows:

Decedent executed her will on Date 1. Article Ninth of Decedent's will provides that the rest and residue of Decedent's estate are to be held in Trust.

Paragraph 1 of Article Ninth provides that during the life of Decedent's two daughters, Daughter 1 and Daughter 2, or the survivor thereof, the net income of Trust is to be paid or accumulated for Daughter 1 and Daughter 2, share and share alike. Accumulated income is to be held as undistributed income for the use and benefit of those entitled thereto subject to the trustee's discretionary right of distribution at such times and in such amounts as it may determine. Upon the death of the survivor of Daughter 1 and Daughter 2 any undistributed income is to be added to the corpus of the trust.

Paragraph 2 of Article Ninth provides that upon the death of the survivor of Daughter 1 and Daughter 2, Trust is to be divided into as many parts as Decedent has grandchildren then surviving or who have previously died leaving issue then surviving. As to each trust, net income is to be paid to or accumulated for the grandchild for whose benefit the trust has been established, or his or her issue, at such times and in such amounts as the trustee may in its sole and unrestricted discretion determine.

Paragraph 2(b) of Article Ninth provides that each trust is to terminate, first, as to each surviving grandchild upon his or her death; second, as to any issue of any nonsurviving grandchild, upon such issue reaching age 21 years or dying prior thereto. Upon the death of any surviving grandchild or issue of any nonsurviving grandchild prior to receiving his or her share of the principal and income, the trust as to such grandchild or issue is to terminate and thereupon the trust estate, principal and undistributed income, is to pass as follows: (aa) dying intestate, to his or her heirs determined by the laws of the state of his or her domicile at the time of his or her death; (bb) dying testate, to such person or persons other than his or her estate, his or her creditors, or creditors of his or her estate, as he or she may have designated in his or her last will and testament. It is intended that each grandchild have a limited power of appointment within the terms of the Internal Revenue Code.

Decedent died on Date 2. Daughter 1 died on Date 3. Daughter 2 died on Date 4.

Decedent's will directs the trustee of each trust to distribute the assets of each trust upon termination in the situation in which a grandchild dies intestate and when a grandchild dies testate and exercises the limited power of appointment in his or her will. However, the will provides no direction if a grandchild dies testate and does not exercise the limited power of appointment in his or her will. This lack of direction created a patent ambiguity in Trust.

On Date 5, the trustee of Trust (Trustee), filed a petition in the County Court to reform certain provisions of Paragraph 2 of Article Ninth of the will that, because of scrivener's error, created a patent ambiguity in Trust. The petition sought to reform subparagraph 2(b)(aa) as follows:

Dying intestate, or dying testate without exercising the limited power of appointment given to said grandchild under Article Ninth, subparagraph (2)(b)(bb), to his or her heirs determined by the laws of the state of his or her domicile at the time of his or her death.

On Date 6, County Court entered an order granting the petition, subject to the issuance of a favorable private letter ruling by the Internal Revenue Service.

## LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, provided no additions (actual or constructive) were made to the trust after that date.

Section 26.2601-1(b)(2) provides that the GST tax does not apply to any generation-skipping transfer under a will or other revocable trust executed before October 22, 1986, provided that the document in existence on October 21, 1986, is not amended at any time after October 21, 1986, in any respect which results in the creation of, or an increase in the amount of, a generation-skipping transfer, and the decedent dies before January 1, 1987. This paragraph also provides that the rules contained in § 26.2601-1(b)(1)(iii) apply to any will or revocable trust within the scope of

this paragraph.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST provisions if: (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(E), Example 3 considers a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the GST tax.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

State Statute 1 provides that a trustee of an express trust by will or other written instrument or a person interested in the trust may petition the district court for an order to construe, interpret, or reform the terms of a trust, or authorize a deviation from the terms of a trust.

State Statute 2 provides that a general residuary clause in a will, or a will making general disposition of all of the testator's property, does not exercise a power of appointment held by the testator unless the testator's will manifests an intention to include property subject to the power.

State Statute 3 provides that if a governing instrument creating a power of appointment expressly requires that the power be exercised by a reference, an express reference, or a specific reference, to the power or its source, it is presumed that the donor's intention, in requiring that the donee exercise the power by making reference to the particular power or to the creating instrument, was to prevent an inadvertent exercise of the power and an attempt to exercise the power by a donee who had knowledge of and intended to exercise the power is effective.

If there are ambiguities in the construction of the terms of an instrument, the court will adopt that construction which will result in sustaining the questioned provision to the end that the intention of the settlor or testator may be carried out. The court can look to the trust instrument as a whole to find such intent. Citation 1.

In this case, the failure to include in Trust a direction for disposition of a grandchild's trust share in the event that the grandchild dies testate but without exercising the grandchild's limited power of appointment is a scrivener's error creating a patent ambiguity. As discussed above, the judicial action involves bona fide issues and the reformation based on scrivener's error is consistent with applicable State law that would be applied by the highest court of State. Accordingly, based on the facts presented and the representations made, we conclude that the reformation of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, the proposed reformation will not cause Trust to lose its status as a GST exempt trust or become subject to the provisions of Chapter 13.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures

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